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INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC FAMILY OFFICE SERVICES



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## Canadian non-resident withholding tax

The impact of non-residents earning investment  
income from Canadian sources

If you're a resident of Canada for tax purposes, you're taxable in Canada on your worldwide income. However, if you're a non-resident of Canada for tax purposes, you're only liable for Canadian tax on certain Canadian source income. While Canadian source income includes income earned from carrying on a business in Canada, rental income from Canadian real estate or Canada Pension Plan retirement benefits, this article focuses on Canadian source investment income such as interest, dividends, mutual fund distributions, limited partnership income and capital gains earned in a non-registered account. The article also addresses Canadian non-resident withholding tax where a non-resident of Canada makes a withdrawal from a Canadian registered plan such as a registered retirement savings plan (RRSP) or a registered retirement income fund (RRIF). Understanding these rules is important because the total tax you pay impacts your after-tax yield on your investment.

### Canadian non-resident withholding tax rules

The following factors may affect the Canadian non-resident withholding tax rate that you may be subject to:

- Canadian domestic tax laws
- Your country of residence for tax purposes
- The tax treaty between Canada and your country of residence if one exists

- The type of income or payment you're receiving
- The type of account in which you hold your investment (registered or non-registered)

### Canadian domestic tax laws and treaties

The general Canadian non-resident withholding tax rate is 25% which applies to certain Canadian-source income paid or credited to non-

residents of Canada. However, the provisions of an income tax treaty between Canada and your country of residence may provide for a reduced withholding tax rate. Some types of income may be exempt from withholding tax altogether.

### Residency

For tax purposes, your residency is generally based on where you spend most of your time, where you work and where your immediate family lives. However, if you spend significant time in more than one country or have ties to more than one country, it may be more difficult to determine your tax residency. Where residency is in question, it's important to seek advice from a qualified tax advisor. For the purposes of this article, the assumption is that you're a non-resident of Canada for tax purposes. If you'd like more information on determining Canadian residency for tax purposes, please ask your RBC advisor for the article on Canadian tax residency.

### Withholding tax on investment income in non-registered accounts

The following sections discuss Canadian non-resident withholding tax rules for various types of Canadian source income.

#### Interest income

Under Canadian domestic tax laws, you won't be subject to Canadian non-resident withholding tax on interest payments you receive as a non-resident from a payor that you're dealing with at arm's length. This exemption will apply to interest you receive from investments such as Canadian corporate bonds, Canadian T-bills and guaranteed investment certificates (GICs).

If you're earning "participating interest" from Canadian sources, it may be subject to withholding tax. Participating interest is interest where all or any portion is contingent or dependent on the use of or production from property in Canada. It also includes all or any portion of interest that's computed by reference to revenue, profit, cash flow, commodity price or any other similar criterion; or computed by reference to dividends paid or payable to shareholders of any class of shares of the capital stock of a corporation.

The exemption from non-resident withholding tax also doesn't apply to interest income you earn through a Canadian mutual fund trust, which will be discussed in a later section.

#### Dividend income

Canadian dividend income you receive from directly investing in Canadian corporations through a non-registered investment account is generally subject to a 25% Canadian non-resident withholding tax. However, if

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Canadian dividend income you earn through a Canadian mutual fund trust is subject to different tax rules which are discussed in a later section.

#### Capital gains

If you dispose of Canadian securities, such as shares or bonds of Canadian corporations or units of Canadian mutual funds, this may result in a capital gain. Generally, capital gains are not subject to non-resident withholding tax. However, where the property you dispose of is taxable Canadian property (TCP), Canadian non-resident withholding tax may apply. Examples of TCP include Canadian real estate, Canadian resource property and Canadian timber resource property. A detailed discussion of Canadian withholding tax on the disposition of TCP is beyond the scope of this article but is briefly discussed in various sections where the TCP is related to a security or is a security that can be purchased on a securities exchange.

Capital gains you earn through a Canadian mutual fund is subject to different tax rules which are discussed in a later section. Note that capital gains earned through a mutual fund is different than a capital gain that arises on the disposition of the mutual fund unit or share.

#### Canadian mutual fund distributions

Canadian mutual funds may be structured as a trust or a corporation. Exchange-traded funds (ETFs) are mutual funds, either a trust or a corporation, which are traded on a securities exchange. Specified investment flow-through trusts (SIFT), otherwise referred to as income trusts, and real estate investment trusts (REITs) are mutual fund trusts which are also generally traded on a securities exchange. SIFTs are mutual fund trusts (other than REITs) that meet all the following conditions at any time during the taxation year:

- the trust is resident in Canada;
- the trust units are listed or traded on a stock exchange or other public market; and
- the trust holds one or more non-portfolio properties.

Generally, SIFTs are carrying on an active business rather than simply passively investing.

For the purposes of this discussion, we will refer to all of these investments as mutual funds.

Mutual funds that are structured as corporations distribute income to shareholders as dividends. Like any other dividend, these dividends are subject to a 25% non-resident withholding tax, unless there's a tax treaty that provides for a reduced tax rate. Mutual fund corporations can also pay capital gains dividends, which are treated differently and are discussed in the next section.

Mutual funds that are structured as trusts may distribute various types of income, such as interest, dividends, royalties and foreign income, to the unitholders. For unitholders who are residents of Canada, the income distributed keeps its character. However, for non-resident unitholders, the income distributed by the trust is simply considered trust income subject to a 25% withholding tax rate unless reduced by a tax treaty. Mutual fund trusts can also distribute capital gains, which are treated differently and are discussed in the next section.

Specific only to SIFTs, when their non-portfolio income (income from active business) is distributed to unitholders, these distributions are deemed to be paid as dividends. When these deemed dividends are paid to a non-resident of Canada, they would be subject to a 25% non-resident withholding tax which may be reduced by a treaty (based on the treaty rate on dividends).

**Capital gain distributions (or dividends) and return of capital**  
Distributions of capital gains, capital gains dividends or a return of capital from Canadian mutual funds are generally exempt from Canadian non-resident withholding tax. However, in some circumstances, Canadian withholding tax can apply. Withholding tax will apply where the capital gain distribution or dividend is derived from the disposition of TCP by the mutual fund, but only if more than 5% of the total amount is distributed to non-resident unitholders. In this case, a 25% Canadian non-resident withholding tax applies unless a tax treaty reduces it.

In addition, where a Canadian mutual fund trust or mutual fund corporation is listed on a designated stock exchange, and where its value is principally attributable to Canadian real estate, Canadian resource property or a timber resource property, withholding tax at a flat rate of 15% will apply to otherwise tax-free distributions made to non-resident investors. This effectively subjects the untaxed portion of capital gains distributions or dividends and any return of capital distributions from such funds to a 15% withholding tax. Where you later realize a loss on the disposition of a unit or share in respect of which this 15%

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withholding tax was paid, a potential refund of tax may be available by filing a section 218.3 return for the year that the unit or share was disposed of. Form 1262, *Part XIII.2 Tax Return for Non-resident's Investments in Canadian Mutual Funds*, is used for this purpose. The loss can be carried back three years or carried forward indefinitely. This is an elective return.

### Limited partnerships

If you invest in a limited partnership that earns Canadian sourced investment income, such as dividends, these sources of income would generally be subject to Canadian non-resident withholding tax. The withholding tax would apply to the partnership as a whole where there's even one non-resident partner. Where Canadian non-resident withholding tax applies to a payment to the partnership, the rate would generally be 25%. Your portion of the Canadian sourced income, as well as your portion of the non-resident withholding tax paid, would flow through to you as a partner.

Capital gains realized by the partnership on the disposition of Canadian property, such as publicly listed shares of a Canadian corporation, would generally not be subject to Canadian non-resident withholding tax. However, where the partnership disposes of TCP or property used in carrying on a business in Canada resulting in a taxable capital gain, the gain retains its identity in your hands and you may be required to file a Canadian non-resident income tax return to include your respective share of the taxable capital gain in your taxable income earned in Canada.

If the partnership is earning income from carrying on a business in Canada, you may be required to file a Canadian non-resident income tax return for the portion of income earned in Canada that is allocated to you.

If you dispose of the partnership units and the units meet the definition of TCP or the partnership is carrying on a business in Canada, you may be required to file a Canadian non-resident income tax return to report this disposition.

This section is a very brief overview of some of the Canadian tax implications related to an investment in a limited partnership earning Canadian sourced income. The rules can be complex so you should consult with a qualified cross-border tax advisor to ensure you understand all of your obligations and options related to your investment in the partnership.

## Withholding tax on withdrawals from registered accounts

### RRSP/RRIF and locked-in retirement accounts

There's no Canadian tax applied on income and capital gains earned within registered plans. However, if your registered plan has investments from sources outside of Canada, there may be foreign taxes that apply to these investments.

If you're a non-resident with an RRSP, RRIF or a locked-in retirement plan, you are subject to Canadian non-resident withholding tax of 25% on withdrawals you make from these registered accounts. Many of Canada's tax treaties provide for a reduced withholding tax rate on withdrawals, and some even provide for an exemption from withholding tax, if certain conditions are met.

For example, there may be a provision in a tax treaty that provides for a reduced withholding rate on periodic pension payments. If the total withdrawals you make from a RRIF in a calendar year are within certain limits, the withdrawals may qualify as periodic pension payments. For many treaty countries, the withholding tax rate on RRIF withdrawals is reduced to 15% for periodic pension payments.

A periodic pension payment from a RRIF is a payment/ withdrawal at any time in a calendar year where the total of all payments/withdrawals made at or before that time and in the year doesn't exceed the greater of:

- Twice the RRIF minimum amount for the year; or
- 10% of the fair market value (FMV) of the RRIF at the beginning of the year.

For the purpose of calculating the periodic pension payment, property or funds transferred to a RRIF in the year and before the withdrawal are considered to have been transferred immediately before the beginning of the particular year (this is the deemed timing of the transfer, but the FMV of the property at the time of the actual transfer to the RRIF is used for the calculation). This means, for purposes of determining the Canadian non-resident withholding tax rate that applies to a withdrawal, in the year the RRIF is established the minimum amount and the FMV of the RRIF at the beginning of the year is not NIL.

Withdrawals from a locked-in plan that is a RRIF for income tax purposes (e.g. life income fund, locked-in retirement income fund and prescribed registered retirement income fund) may also be considered periodic pension payments if the withdrawals meet the limits just described.

### Taxable distributions from an RESP, an RDSP or a TFSA

If a taxable distribution is made to a non-resident from a registered education savings plan (RESP), a registered disability savings plan (RDSP) or a tax-free savings account (TFSA), the distribution will be subject to a 25%

In some cases, financial institutions may withhold Canadian non-resident withholding tax from tax-exempt income or may have withheld at a rate more than the treaty rate.

Canadian non-resident withholding tax rate. For an RESP or RDSP, the non-resident beneficiary will be subject to non-resident tax on their taxable withdrawals (which is generally any investment income earned in the account and not the original contributions; and in the case of an RDSP, also the grants and bonds). For a TFSA, a taxable distribution may result if the FMV of the TFSA on the date of distribution to the beneficiary is greater than the FMV at the date of death of the TFSA owner.

### What to do if excess non-resident tax is withheld

In some cases, financial institutions may withhold Canadian non-resident withholding tax from tax-exempt income or may have withheld at a rate more than the treaty rate. In these cases, you can apply to the Canada Revenue Agency (CRA) for a refund of excess withholding taxes by filing Form NR7-R, *Application for Refund of Part XIII Tax Withheld*, no later than two years after the end of the calendar year in which the financial institution remitted the tax withheld to the CRA. It's possible that you may have longer than two years depending on the tax treaty Canada has signed with your country of residence.

### Canadian tax filing requirements for non-residents

As a non-resident of Canada, you generally won't be required to file a Canadian income tax return if you earn the types of Canadian source investment income or receive the types of payments discussed in this article if sufficient non-resident tax was withheld (except where specifically highlighted).

If you're subject to Canadian non-resident withholding tax but the amount withheld at source is not sufficient to cover your Canadian tax liability, you are still liable for the tax. You must remit the balance to the CRA (International Tax Services Office). Speak to a qualified tax advisor for advice about making a remittance payment. In some instances, your financial institution may try to recover the shortfall from you so that they can remit it to the CRA.

If you dispose of TCP, you may have a Canadian tax filing requirement. In the context of investing in the securities market, TCP includes an interest in a partnership, if at any time in the previous 60-month period, more than 50% of its FMV was derived from one or any combination of

real or immovable property located in Canada, Canadian resource property or timber resource property. If you find yourself in this position you should consult with a qualified tax advisor to determine what your Canadian tax filing requirements are, if any.

You may also have a Canadian tax filing requirement if you dispose of a life insurance policy in Canada or invest in a limited partnership that carries on a business in Canada. There are other instances where you may need to file a Canadian tax return that have not been addressed because it's beyond the scope of this article.

Even if you don't have to file a Canadian tax return, in some circumstances, you may still want to file certain Canadian elective returns, if beneficial.

### **Electing to file a section 217 income tax return**

In some cases, you may want to file a Canadian section 217 return. The filing of the return allows qualifying income to be taxed at graduated tax rates on a Canadian income tax return. You may also be able to claim all or a portion of certain non-refundable tax credits and deductions, such as the personal amount, the age amount, and the pension income tax credit.

Generally, low-income non-residents who receive qualifying income (e.g. RRSP or RRIF payments) may benefit from this election. Some examples of other types of qualifying income, not discussed in this article, include Canada Pension Plan or Quebec Pension Plan benefits and Old Age Security.

There may be limited circumstances where the election is beneficial. This is because the calculation of your Canadian tax liability takes into account your worldwide income level which may result in a higher effective tax rate than the fixed non-resident withholding tax rate. Electing to file a Canadian tax return under section 217 may only make sense if the tax liability is lower than the tax at the fixed non-resident withholding tax rate that applies to you. In addition, if the income will be subject to a higher tax rate in your country of residence and you're able to claim a foreign tax credit, your combined tax liability of both countries may not be minimized by making this election. You should discuss with a qualified tax advisor whether it makes sense for you to make this election.

Where you intend to file a section 217 Canadian tax return, you may also want to consider filing a Form NR5, *Application for a Reduction in the Amount of Non-Resident Tax Required to be Withheld*, to request a reduction in non-resident tax that's withheld at source on qualifying income. Where the CRA finds that a section 217 election will be beneficial to you, they may authorize Canadian payers to reduce non-resident withholding tax at source. Where

There may be restrictions on your ability to invest in an account located in Canada or in certain foreign investments. In addition, the tax laws in your country of residence may require additional reporting and disclosure of foreign income and accounts.

an NR5 form is approved, a section 217 tax return must be filed for each year of approval.

### **Electing to file a section 218.3 income tax return**

This type of elective return was already discussed in the section on Canadian mutual funds. You may consider filing a section 218.3 return if you invested in a publicly traded Canadian mutual fund that was subject to a 15% withholding tax on otherwise tax-free distributions and later realized a loss on the disposition of that mutual fund.

### **Consider the laws in your country of residence**

There may be restrictions on your ability to invest in an account located in Canada or in certain foreign investments. In addition, the tax laws in your country of residence may require additional reporting and disclosure of foreign income and accounts. Canadian source income or payments may also be subject to tax in your country of residence; however, many countries allow foreign tax credits to be claimed for the Canadian tax paid to eliminate or reduce double taxation.

You should seek advice from a qualified tax and legal advisor in your country of residence before making any foreign investments.

### **Conclusion**

When investing in Canada as a non-resident, it's important to understand both the Canadian tax implications and the tax and legal implications in your country of residence since the total tax you pay, or any additional costs, will affect your return on investment.

*This article may contain strategies, not all of which will apply to your particular financial circumstances. The information in this article is not intended to provide legal, tax or insurance advice. To ensure that your own circumstances have been properly considered and that action is taken based on the latest information available, you should obtain professional advice from a qualified tax, legal and/or insurance advisor before acting on any of the information in this article.*



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